

**UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION**

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Inquiry Concerning )  
Alternative Power Pooling Institutions ) Docket No. RM94-20-000  
Under the Federal Power Act )

**REPLY COMMENTS OF THE U.S. DEPARTMENT OF JUSTICE**

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April 3, 1995

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These reply comments are filed by the U.S. Department of Justice (Department) in response to the notice of Inquiry Concerning Alternative Power Pooling Institutions under the Federal Power Act (Notice) published by the Federal Energy Regulatory Commission (Commission).<sup>1</sup> The Notice posed general questions about the desirability and role of “alternative power pooling institutions.” One particular institution on which the Commission requested comment was the “PoolCo.”<sup>2</sup>

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<sup>1</sup> 59 Fed. Reg. 54,851.

<sup>2</sup> As the term is used by the Department, a “PoolCo” is any entity that makes a real-time spot market in electric power and accomplishes voluntary purchases and sales by dispatching generating plants in a price-merit order unaffected by ownership of generation or transmission. Many possible manifestations of a PoolCo satisfy this definition, and there are not yet any detailed PoolCo proposals before the Commission or the Department.

The British-Welsh pool, for example, falls within this definition, and participants in the PoolCo debate in this country rightly point to problems that have arisen with it. The Department views that experience as evidence that PoolCos are undesirable absent certain market conditions and safeguards. Among several shortcomings of the British-Welsh pool is the fact that the generation market is too concentrated to perform competitively.

## Statement of Position

Provided certain market conditions and safeguards are in place, PoolCos could help complete the transformation of the electric power generation industry from regulated monopolies to openly competitive and effectively unregulated markets. Among PoolCos with the necessary safeguards, the Department does not endorse any particular plan. Nor has the Department concluded a PoolCo is necessarily preferable to other market institutions that may efficiently allocate electricity supply. Finally, buyers and seller should be free to trade bilaterally, outside any PoolCo.

The Department views the PoolCo concept as one of several potentially beneficial market institutions under discussion or in use today. The PoolCo concept merits further development by academics, buyers, and sellers who believe that it offers advantages over alternatives. The Commission, however, should issue a policy statement setting out safeguards necessary to protect competition, preserve freedom of choice, and prevent abuses. The Department would welcome the opportunity to comment on a proposed policy statement on PoolCos and on actual PoolCo applications to the Commission.

A Commission policy statement on PoolCos could foster the development of specific PoolCo proposals by reducing uncertainty about the Commission's likely response to a specific PoolCo proposal. By articulating prohibited activities (e.g., restrictions on participation or unequal access to transmission), a policy statement could usefully narrow the range of possibilities that must be considered. By signaling structural or other conditions under which a PoolCo will not be approved, a policy statement can allow PoolCo proponents to avoid fruitless efforts to develop specific PoolCos that would not be approved, and can allow utilities to alter market structure (e.g., by selling off some generating capacity) in advance of presenting a specific PoolCo proposal to the Commission.

***The policy statement should require that the control of PoolCo operations be independent of any owner of generation.*** Equal transmission access for all buyers and sellers is essential for effective competition. A properly structured PoolCo could facilitate the provision of equal transmission access, without resort to complex and cumbersome regulations. A properly structured PoolCo could accomplish this by divesting utilities of control over the dispatch of their plants.

***The policy statement should set out other basic requirements necessary to prevent abuses.*** The Commission should state that PoolCos must be open to all buyers and sellers that wish to participate, that all can participate on equal terms, and that all will have equal access to transmission. The Commission also should state that it will not approve a PoolCo with unreasonable operational rules, such as the requirement of unanimous consent for decision making.

***The policy statement should state that the Commission will not approve any PoolCo proposal unless the relevant bulk power markets are sufficiently competitive to reasonably assure that the benefits of eliminating traditional rate regulation exceed the costs.*** PoolCos, as well as other market institutions, rely on competition among buyers and sellers to yield efficient, competitive prices. If there is sufficient competition, the use of market mechanisms to set prices is clearly preferable to traditional rate regulation. A PoolCo, however, cannot create competition in a market with a structure not conducive to competition.

***The policy statement should state that the Commission will not approve any PoolCo proposal unless the related transmission planning and pricing plans would provide the necessary incentives to invest in the transmission system and to utilize generation and transmission resources efficiently.*** PoolCos and other market mechanisms offer prospects of significant efficiencies, but inefficient transmission pricing and other arrangements can cause an inefficient utilization of resources and greatly undermine these efficiencies.

***The policy statement should allow PoolCo proposals to develop through private negotiation.*** Whether a particular PoolCo is preferable to other trading institutions is a decision to be made in the first instance by buyers and sellers. The Department opposes any action by the Commission that would tend to force reliance on PoolCos rather than other market institutions. Apart from necessary safeguards, the specifics of a particular PoolCo proposal should be left to buyers and sellers.

***The policy statement should make clear that participation in PoolCos should be voluntary and that PoolCos will not be granted any special privileges.*** If, for any reason, buyers and sellers prefer to contract outside the PoolCo, they should be permitted to do so, through bilateral contracts or through some market institution other than a PoolCo. PoolCos also should not be granted any special privileges, such as preferential transmission access, which could dissuade buyers and sellers

from trading outside the PoolCo when they otherwise would prefer to do so. If a PoolCo is the most efficient trading institution, buyers and sellers can be expected to use it voluntarily. If it is not, buyers and sellers can be expected to turn elsewhere, and the PoolCo will disappear.

*The policy statement should state that PoolCos should not be used as a mechanism for recovering stranded investment costs.* The efficiency benefits of market-based pricing can be undermined by add-ons to PoolCo prices or transmission prices that do not reflect the economic costs associated with particular transactions.

## **Response to Initial Comments Filed by Others**

### **The Overriding Importance of Competitive Market Structure**

In their initial comments in this docket, several commenters voiced a concern raised by the Department—that dominant generators may be able to exercise market power within a PoolCo (although a properly structured PoolCo, in and of itself, cannot create market power).<sup>3</sup> As the Department stated in its initial comments, the Commission should not reject the PoolCo concept altogether just because it would not be beneficial in some circumstances; rather, the Commission should clearly state that it will not approve any PoolCo proposal where the relevant generation markets would not be sufficiently structurally competitive.

A few commenters contended that a PoolCo would necessarily constitute a monopoly buyer, a monopsony seller, or both, and therefore is inherently undesirable.<sup>4</sup> As the Department understands the PoolCo concept, a PoolCo would

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<sup>3</sup> Comments of the California Manufacturers Association (CMA Comments) at 6–7; Initial Comments of the Coalition for a Competitive Electric Market (CCEM Comments) at 22; Comments of the Electricity Consumers Resource Council, American Iron and Steel Institute, Chemical Manufacturers Association, American Forest & Paper Association, and the Council of Industrial Boiler Owners (ELCON Comments) at 22–23.

<sup>4</sup> CCEM Comments at 20, 23–24; Comments of the Electric Generation Association to the Federal Energy Regulatory Commission Regarding the Commission’s Inquiry Concerning Alternative Power Pooling Institutions under the Federal Power Act (EGA Comments) at 7–8.

not be a “buyer” or “seller” in any relevant sense of the terms, much less the only buyer or seller. The Commission should make clear that PoolCos can only operate as market makers and not as traders for their own accounts. As further elaborated below, the Commission should also preclude mandatory PoolCos. Like any other market maker, PoolCo should not be a monopoly provider of market-making services unless buyers and sellers all find it more efficient than alternative market institutions.

### **PoolCos Would Be Fully Subject to the Antitrust Laws**

Two commenters suggested that Commission approval of a PoolCo would confer antitrust immunity on it.<sup>5</sup> While this is not the law, the Commission should also make clear that it intends that the antitrust laws apply fully to PoolCos.

In *Otter Tail Power Co. v. United States*,<sup>6</sup> the Supreme Court held that the antitrust laws apply to the electric power industry despite its extensive regulation. Courts of appeals have applied the antitrust laws to the electric power industry in many cases involving refusals to wheel<sup>7</sup> and price squeezes.<sup>8</sup> The Supreme Court has admonished that “[r]epeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain

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<sup>5</sup> CCEM Comments at 18; Comments of the Industry Structure Coalition of the Power Marketing Association in Response to the Inquiry Concerning Alternative Power Pooling Institutions under the Federal Power Act (ISC Comments) at 2 n.2, 8.

<sup>6</sup> 410 U.S. 366, 372–73 (1973). For a recent reaffirmation, see *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 21 (1st Cir. 1990) (opinion by Breyer, J.).

<sup>7</sup> *E.g.* *Cities of Anaheim v. Southern California Edison Co.*, 941 F.2d 1234 (9th Cir. 1992); *City of Malden v. Union Electric Co.*, 887 F.2d 157 (8th Cir. 1989); *City of Chanute v. Kansas Gas & Electric Co.*, 754 F.2d 310 (10th Cir. 1985); *Borough of Lansdale v. Philadelphia Electric Co.*, 692 F.2d 307 (3d Cir. 1982); *City of Groton v. Connecticut Light & Power Co.*, 662 F.2d 921 (2d Cir. 1981).

<sup>8</sup> *E.g.* *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 21 (1st Cir. 1990) (opinion by Breyer, J.); *City of Kirkwood v. Union Electric Co.*, 671 F.2d 1173 (8th Cir. 1982); *City of Mishawaka v. Indiana & Michigan Electric Co.*, 560 F.2d 1314 (7th Cir. 1977).

repugnancy between the antitrust and regulatory provisions.”<sup>9</sup> In *Otter Tail*, the Supreme Court rejected defendant’s argument that the Commission’s jurisdiction to order interconnections impliedly repealed the antitrust laws, stating: “When . . . relationships are governed in the first instance by business judgment and not regulatory coercion, courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws.”<sup>10</sup> Since whether to create a PoolCo and whether to participate in it, as well as the specific rules of a PoolCo, all should be “governed in the first instance by private business judgment and not regulatory coercion,” there should be no implied repeal.<sup>11</sup>

One commenter argued that PoolCos would foster predatory pricing by large utilities against their smaller competitors if “the antitrust laws are not properly applied.”<sup>12</sup> However, the assumption that the antitrust laws would not be properly applied is not justified. Further, the Commission should not approve a PoolCo unless the relevant markets are sufficiently structurally competitive, and predation is unlikely to arise in competitive markets. Finally, buyers and sellers would be free to trade outside any PoolCo, and this would provide further protection against predatory conduct.

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<sup>9</sup> *United States v. Philadelphia National Bank*, 374 U.S. 321, 350–51 (1963). This holding was reaffirmed in *National Gerimedical Hospital and Gerontology Center v. Blue Cross of Kansas City*, 452 U.S. 378, 379 (1981).

<sup>10</sup> 410 U.S. at 374.

<sup>11</sup> *Cf. Cantor v. Detroit Edison Co.*, 428 U.S. 579, 596–98 (1976); *City of Kirkwood v. Union Electric Co.*, 671 F.2d 1173, 1178 (8th Cir. 1982); *City of Mishawaka v. Indiana & Michigan Electric Co.*, 560 F.2d 1314, 1321 (7th Cir. 1977). For a useful discussion of the law on implied repeal, see *American Agriculture Movement v. Board of Trade of the City of Chicago*, 977 F.2d 1147, 1163–67 (7th Cir. 1992).

<sup>12</sup> Initial Comments of the National Independent Energy Producers on the Notice of Inquiry (NIEP Comments) at 13–14.

## **The Commission Should Not Mandate PoolCos and Participation in them Should Be Voluntary**

The Department agrees with the many commenters that argued that the Commission should take a neutral stance with regard to the formation of PoolCos.<sup>13</sup> The decision to rely on one mechanism rather than another, or to rely on several simultaneously, should not be made by the Commission.<sup>14</sup> The Department suggests that the Commission clearly state in a policy statement that it does not intend to force the PoolCo model on buyers and sellers and that participation in a PoolCo should be voluntary.<sup>15</sup>

The Commission's policy statement should not prohibit groups of buyers or sellers from agreeing among themselves to deal exclusively through a PoolCo or to make minimum volume commitments for use of the PoolCo. Agreements of this sort should be evaluated under the antitrust laws as are other agreements among competitors.<sup>16</sup>

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<sup>13</sup> *E.g.* Comments of the California Municipal Utilities Association on FERC's Notice of Inquiry on Alternative Power Pooling Institutions under the Federal Power Act; CCEM Comments at 18; CMA Comments at 8; Comments of Edison Electric Institute at 17–22, 31; EGA Comments at 10–11; ELCON Comments at 5, 24; ISC Comments at 13; NIEP Comments at 16; NYMEX Comments at 7.

<sup>14</sup> Of course, any such mechanisms must be “just and reasonable” under the Federal Power Act and lawful under the antitrust laws.

<sup>15</sup> One commenter expressed the concern that the Commission would force the PoolCo model on buyers and sellers. ISC Comments esp. at 13, 16. It and another expressed the concern that PoolCo participation would be mandatory. CCEM Comments at 12; ISC Comments at 2 n.2. The same two commenters expressed the concern that PoolCos might be effectively mandatory because they would be conferred special privileges, such as reduced regulatory oversight or preferential access to transmission. CCEM Comments at 14; ISC Comments at 2 & n.2, 7. The Department suggests that the Commission clearly state in a policy statement that it intends to confer no special privileges on PoolCos and that pool and nonpool transactions should be treated as equally as reasonably possible for all purposes.

<sup>16</sup> Some exclusive arrangements or minimum volume commitments could be necessary for a PoolCo to achieve a minimum efficient scale of operation, while commitments beyond that scale could have the anticompetitive effect of excluding other market institutions. The basic concept of voluntary participation in a PoolCo should not be undermined through agreements among buyers and sellers.



## Self-Dealing Problems

One commenter expressed concern about self-dealing between generators and affiliated distribution companies subject to traditional rate-of-return regulation. Integrated utilities could pay affiliated generators supracompetitive prices, which would be passed through to retail customers, potentially foreclosing more efficient generators.<sup>17</sup> This is a very real concern and a potentially vexing problem for regulators. A properly structured PoolCo, however, could help solve the problem rather than exacerbate it. The potential for abuse could be eliminated by prohibiting distribution companies from purchasing from affiliated generators *except* through a properly structured PoolCo.<sup>18</sup> With such a prohibition, it would be impossible to pay affiliated generators any more than unaffiliated generators.

Several commenters expressed concern that having the PoolCo manage the transmission system might lead to preferential transmission access for PoolCo transactions, and that could greatly inhibit non-PoolCo transactions.<sup>19</sup> A solution to this potential problem would be to have a separate TransCo operate the transmission system. Like a PoolCo, a TransCo would have to be operated independently of owners of generation or transmission, and restrictions on its ownership may be desirable to ensure such independence. The Commission should attempt to determine whether this concern is substantial and whether there would be lost efficiencies from separating the operation of the transmission system from the dispatch function performed by the PoolCo.

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<sup>17</sup> NIEP Comments at 6–8.

<sup>18</sup> State regulators should determine the best solution to the problem. In making this determination, they should consider the fact that forcing a large volume of transactions through a PoolCo could affect the viability of other market institutions. They should also consider switching from rate-of-return to incentive regulation (i.e., price caps).

<sup>19</sup> CCEM Comments at 14–15; NIEP Comments at 4–5; NYMEX Comments at 19.

### **PoolCos Should Not Be Used to Deal with Stranded Investment**

One of the major issues facing the electric power industry today is "stranded investment," that is, investments made by utilities for which they might not be compensated in a competitive environment. The Notice posed the question of whether PoolCos have the potential to resolve problems of stranded investment.

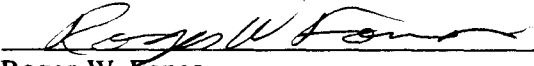
The Commission should disavow any linkage between recovery of stranded investment and approval of PoolCos. Neither wholesale generation prices nor transmission prices should be distorted in the name of recovering stranded investment costs. Among other things, the Department opposes making a PoolCo mandatory to facilitate recovery of stranded investment costs, and it opposes the use of an additional charge, like the British-Welsh "uplift," if it would reflect things other than congestion and other economic costs of a transaction.

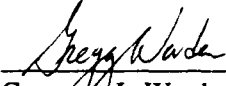
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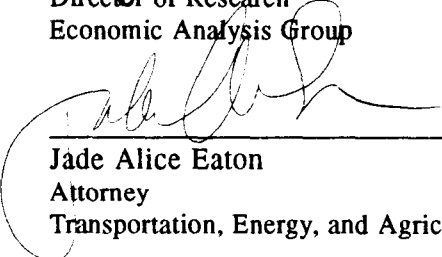
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